

Message Text

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R 152344Z APR 75

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 0241

INFO AMEMBASSY BONN

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DEPARTMENT PASS TREASURY AND FRB, NEW DELHI FOR SECRETARY
SIMON'S PARTY

E.O. 11652:N/A

TAGS: ECON, UK

SUBJECT: UK BUDGET; DOMESTIC ASPECTS; A SLIGHTLY DEFLA-
TIONARY BUDGET TO OFFSET WAGE INCREASES

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BEGIN SUMMARY: CHANCELLOR OF THE EXCHEQUER DENIS HEALEY

PRESENTED WHAT APPEARS, AT FIRST GLANCE AT LEAST, AS A SLIGHTLY DEFLATIONARY BUDGET IN AN EFFORT TO REDUCE THE INFLATIONARY PRESSURES IN THE UK. HEALEY WARNED OF THE DANGERS OF INFLATION IN HIS BUDGET SPEECH AND BLAMED BRITISH UNIONS DIRECTLY FOR EXACERBATING INFLATIONARY TRENDS BY NOT ADHERING TO THE "SOCIAL CONTRACT." THE CHANCELLOR FORESAW THE INCREASE IN UNEMPLOYMENT TO CONTINUE UNTIL INFLATION IS UNDER CONTROL. HEALEY PROMISED TO MAINTAIN CONTINUED CONSTRAINTS ON MONETARY EXPANSION AND BROUGHT FORWARD SUBSTANTIAL TAX INCREASES, PARTICULARLY IN THE MIDDLE AND UPPER INCOME LEVELS, AND PROMISED A SIZABLE REDUCTION IN PUBLIC EXPENDITURE IN 1976. BOTH INDIRECT AND DIRECT PERSONAL TAXES WILL BE INCREASED AND THE CORPORATION TAX WILL BE ACCELERATED. AT THE SAME TIME TAX RELIEF TO COMPANIES FOR INVENTORY APPRECIATION WILL CONTINUE AND FISCAL INVESTMENT INCENTIVES ARE TO BE EXPANDED. THERE IS SOME TAX RELIEF AT LOWER INCOME LEVELS. OUR INITIAL REACTION IS THAT THE BUDGET WILL HAVE A DEFLATIONARY EFFECT ON DEMAND THROUGH BOTH THE INDIRECT TAX INCREASES AND THROUGH RESTRAINT OF THE PUBLIC SECTOR DEFICIT. IT WILL PROBABLY NOT PLEASE THE UNIONS OR THE LABOR PARTY LEFT, THOUGH ITS SLIGHT REDISTRIBUTIONAL ASPECTS MAY LEAVEN SOME OF THEIR FIRE. END SUMMARY

1. THE INDIRECT TAX PROPOSALS IN THE HEALEY BUDGET ARE:

A) VAT TO BE INCREASED FROM 8 PERCENT TO 25 PERCENT ON "LESS ESSENTIAL" GOODS, MAINLY CONSUMER DURABLES. THESE INCLUDE MOST ELECTRICALLY OPERATED APPLIANCES SUCH AS IRONS, WASHING MACHINES, RADIOS, TV'S, HI-FI EQUIPMENT, SMALL BOATS, SMALL AIRCRAFT, CAMERAS AND PHOTOGRAPHIC EQUIPMENT, FURS, JEWELRY, AND MANY OTHER ITEMS. THIS INCREASE IS ESTIMATED TO YIELD 325 MILLION POUNDS PER YEAR.

B) EXCISE TAXES WILL BE INCREASED AS FOLLOWS:

1. BEER TAX UP 2 PENCE PER PINT;
2. ALCOHOL (SPIRITS) TAX UP 64 PENCE PER STANDARD BOTTLE;
3. WINE TAX UP 24 PENCE PER STANDARD BOTTLE;
4. CIGARETTE TAX UP 7 PENCE PER 20.

C) GAMING DUTIES INCREASED.

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D) VEHICLE LICENSE TAXES TO BE INCREASED BY 60 PERCENT. FOR AUTOMOBILES THE LICENSE FEE WILL RISE FROM 25 TO 40 POUNDS.

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2. DIRECT PERSONAL TAX PROPOSALS IN THE BUDGET ARE:

A) SEVERAL MINOR CHANGES TO CLOSE LOOPHOLES.

B) EARNINGS CEILING ON NATIONAL INSURANCE CONTRIBUTIONS INCREASED.

C) THE BASIC RATE OF INCOME TAX RAISED BY 2 PERCENT.

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THUS, THE RATE OF 33 PERCENT AT INCOME BELOW 5,000 POUNDS IS RAISED TO 35 PERCENT, AND ALL RATES ARE UP BY 2 PERCENT EXCEPT THE HIGHEST RATE (83 PERCENT AT 20,000 POUNDS). THE INVESTMENT INCOME TAX IS NOT RAISED.

D) PERSONAL ALLOWANCES ARE RAISED. THUS, THE TAX THRESHOLD AT WHICH PEOPLE START PAYING TAX IS RAISED, GIVING SOME TAX RELIEF TO LOW INCOME EARNERS.

3. CORPORATE TAX:

A) RATE REMAINS 52 PERCENT.

B) TAX RELIEF FOR INVENTORY APPRECIATION, ANNOUNCED IN NOVEMBER "MINI-BUDGET" WILL CONTINUE, BUT IS EXPANDED TO INCLUDE ALL COMPANIES AND ALL WORK IN PROGRESS (INCLUDING PROFESSIONAL WORK); IT IS RESTRICTED TO EXCLUDE LAND NOT HELD FOR PURPOSE OF CONSTRUCTING BUILDINGS FOR SALE.

C) OIL COMPANY LOSSES FROM TRANSACTIONS AT ARTIFICIAL PRICES IN OVERSEAS OIL WILL NOT BE ALLOWABLE AS OFFSET TO PROFITS.

D) CORPORATION TAX SLIGHTLY ACCELERATED.

4. INVESTMENT INCENTIVES:

A) 100 MILLION POUNDS WILL BE ALLOCATED, FIRST TO ASSIST INVESTMENT PROJECTS WHICH HAD BEEN PLANNED BY COMPANIES BUT ARE NOW POSTPONED BECAUSE OF UNCERTAINTY, OR CASH PROBLEMS. THE CRITERIA FOR SUCH PROJECTS ARE: (1) MUST BE NEW AND SUBSTANTIAL (OVER 2.5 MILLION POUNDS); (2) MUST BE NET ADDITION TO FIRM'S CAPITAL INVESTMENT PROGRAM; (3) INVOLVE A DIRECT AND SUBSTANTIAL BENEFIT TO UK BALANCE OF PAYMENTS; (4) WORK SHOULD HAVE COMMENCED IN NEXT 12 MONTHS. SECOND PART OF THESE FUNDS WILL BE AVAILABLE FOR MODERNIZATION, RATIONALIZATION, RESTRUCTURING OF SPECIFIC INDUSTRIES.

B) CHANGES IN THE PRICE CODE TO RAISE THE INVESTMENT RELIEF ANNOUNCED IN THE NOVEMBER "MINI-BUDGET" AT 17-1/2 PERCENT TO 20 PERCENT AND EXTEND IT TO COMMERCIAL VEHICLES. INVESTMENT RELIEF IN THE PRICE CODE WILL BE EXTENDED TO COVER INVESTMENT IN EXPORTING AND THE SECRETARY OF STATE FOR PRICES AND CONSUMER PROTECTION WILL GET POWER TO GIVE RELIEF FROM THE

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PRICE CODE WHERE THIS WOULD ASSIST THE BALANCE OF PAYMENTS.

5. PUBLIC EXPENDITURE WILL BE CUT BY 900 MILLION POUNDS IN

FISCAL YEAR 1976/77 (AT 1974 PRICES), BUT THERE WILL BE NO MAJOR CUTS IN 1975/76. OF THIS CUT, 110 MILLION POUNDS WILL COME OUT OF DEFENSE, WHILE OTHER CURRENT PROGRAMS WILL BE REDUCED BY 1-1/2 PERCENT OVERALL AND CAPITAL EXPENDITURE BY 10 PERCENT. FOOD SUBSIDIES WILL FALL BY 150 MILLION POUNDS, HOUSING SUBSIDIES BY 65 MILLION POUNDS, AND NATIONALIZED INDUSTRY SUBSIDIES FOR PRICE RESTRAINT SHOULD BE REDUCED BY ABOUT 450 MILLION POUNDS IN THE PRESENT FISCAL YEAR.

6. PUBLIC SECTOR DEFICIT. HEALEY ANNOUNCED IN THE BUDGET PRESENTATION THAT HE EXPECTED A PUBLIC SECTOR BORROWING REQUIREMENT OF ABOUT 9 BILLION POUNDS THIS FISCAL YEAR. THIS WILL BE ABOUT 10 PERCENT OF GDP. HEALEY STATED THAT THE BUDGET MEASURES WILL REDUCE IT BY ABOUT 1 BILLION POUNDS FROM WHAT IT WOULD HAVE BEEN IN 1975/76. HE EXPECTS THESE MEASURES TO REDUCE PUBLIC SECTOR BORROWING BY 3 BILLION POUNDS IN 1976/77.

7. COMMENT. THE KEY FACTOR IN THE BUDGET APPEARS TO BE DOMESTIC INFLATION. IT SEEMS CLEAR THAT ITS THRUST IS TO REDUCE INFLATION BY DRAWING BACK MONEY FROM CONSUMERS (REDUCING SPENDING POWER - THUS THE IMPACT OF THE HIGH WAGE INCREASES) AND THROUGH SOME MODERATION OF THE GROWTH OF PUBLIC SECTOR BORROWING. HEALEY STATED FIRMLY THAT MONETARY GROWTH WOULD BE CONTROLLED, BUT ONE REQUIREMENT IN DOING THAT IS TO CONTROL THE GROWTH OF PUBLIC SECTOR BORROWING.

8. THE BUDGET IS ALSO FURTHER IMPETUS TO GOVERNMENT ECONOMIC STRATEGY OF DIVERTING RESOURCES FROM DOMESTIC CONSUMPTION TO EXPORTS AND INVESTMENT. WHEN ECONOMIC GROWTH RESUMES, THE IDEA IS THAT IT BE EXPORT/INVESTMENT-

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LED. INCREASED TAXATION WILL REDUCE CONSUMPTION AND THE INCENTIVES GIVEN INVESTMENT AND EXPORTS MAY, AT THE MARGIN, INDUCE MOVEMENT OF SOME RESOURCES TO THOSE SECTORS.

9. THERE ARE 2 DANGERS IN THIS BUDGET, HOWEVER. FIRST, IT COULD BE TOO DEFLATIONARY IN ECONOMIC TERMS. THAT IS LIMITED OFFICIAL USE

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DEMAND COULD BE REDUCED TO SUCH AN EXTENT AS TO FURTHER REDUCE ALREADY BADLY SHRUNKEN INVESTMENT PROSPECTS, DESPITE THE INVESTMENT INCENTIVES IN THE BUDGET. SHOULD THIS OCCUR, IT WOULD EXACERBATE THE RECESSION AND INCREASE THE GROWTH RATE OF UNEMPLOYMENT. IT WOULD ALSO DIMINISH EXPORT PROSPECTS IN THE FUTURE BY NOT ADDING SUFFICIENTLY TO CAPACITY AND COULD SOW THE SEEDS OF FURTHER INFLATIONARY PROBLEMS WHEN THE UPSWING COMES.

10. A SECOND PROBLEM IS POLITICAL. HOW THE UNIONS AND THE LABOR PARTY LEFT-WING WILL REACT TO THE BUDGET IS NOT YET KNOWN. BUT THE TUC AND MOST OF THE PARTY LEFT HAVE BEEN CALLING FOR A REFLATIONARY BUDGET. CERTAIN OF THEIR REQUESTS, SUCH AS INCREASING THE TAX THRESHOLD FOR THE

LOW PAID HAVE BEEN MET. BUT THEIR GENERAL DESIRE TO REDUCE UNEMPLOYMENT HAS NOT. THIS MAY COMPLICATE THE GOVERNMENT'S POLITICAL POSITION, INCLUDING THE EC REFERENDUM, AND EXACERBATE LABOR PARTY INTERNAL STRIFE.

11. THERE IS ALSO THE PROBLEM OF WAGES. THE BUDGET IS DESIGNED IN PART TO REDUCE PURCHASING POWER PERMITTED BY LARGE WAGE INCREASES. BUT IT IS POSSIBLE THAT IT WILL ONLY ENCOURAGE UNIONS TO ACCELERATE WAGE CLAIMS, BOTH IN TERMS OF TIME AND AMOUNT. IF SO, THE WAGE SPIRAL, WHICH IS THE MAIN (AND ONLY) CAUSE OF PRESENT UK INFLATION WILL CONTINUE. IN THAT CASE, THE PROBLEMS WHICH THE BUDGET WAS DESIGNED TO REMEDY WILL STILL BE ACUTE THROUGHOUT THIS YEAR, AND WE COULD EXPECT FURTHER MEASURES TO COMBAT INFLATION.

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